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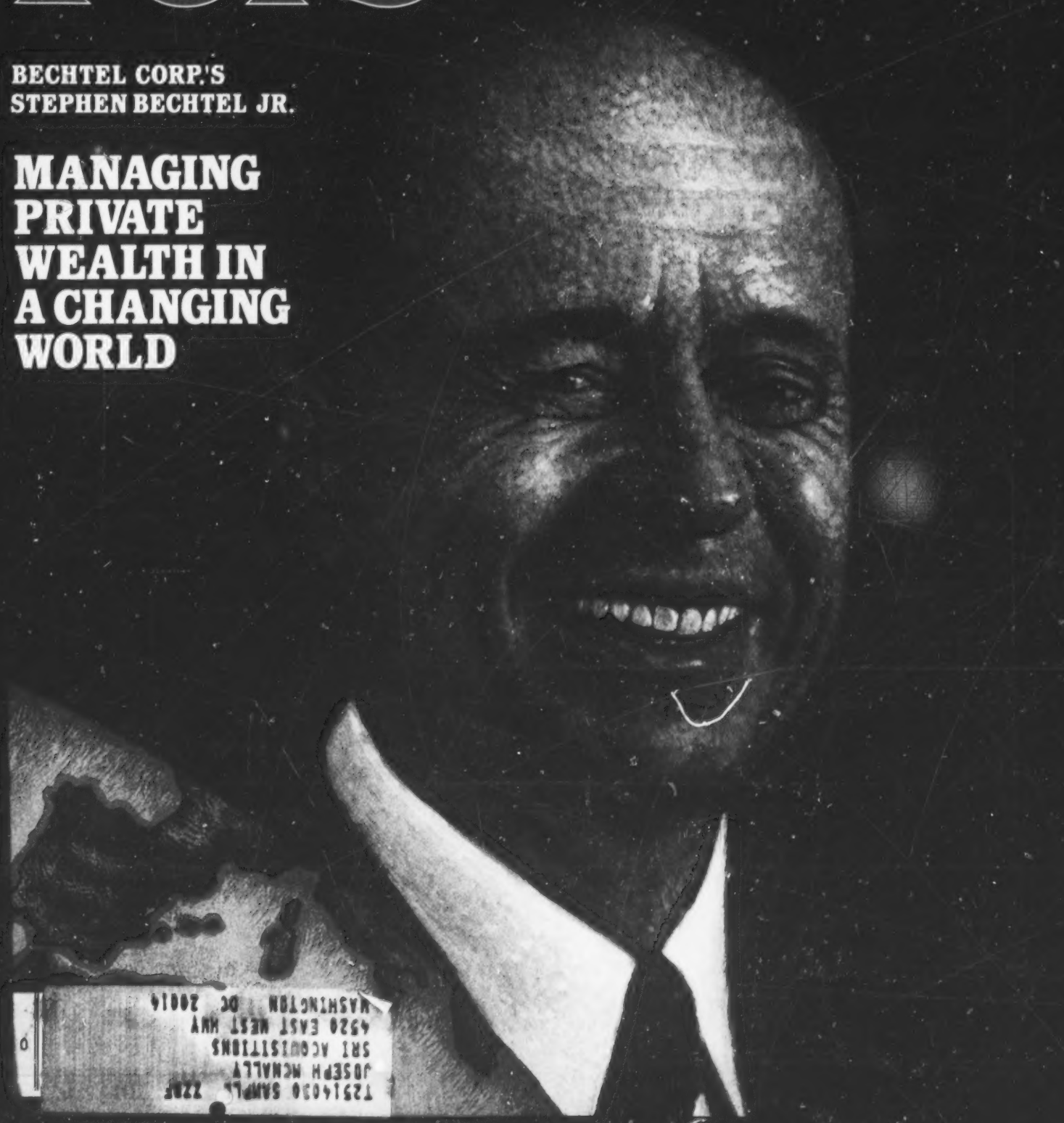

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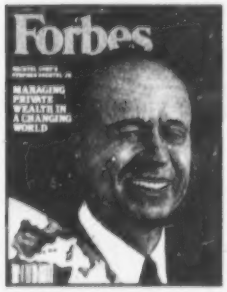

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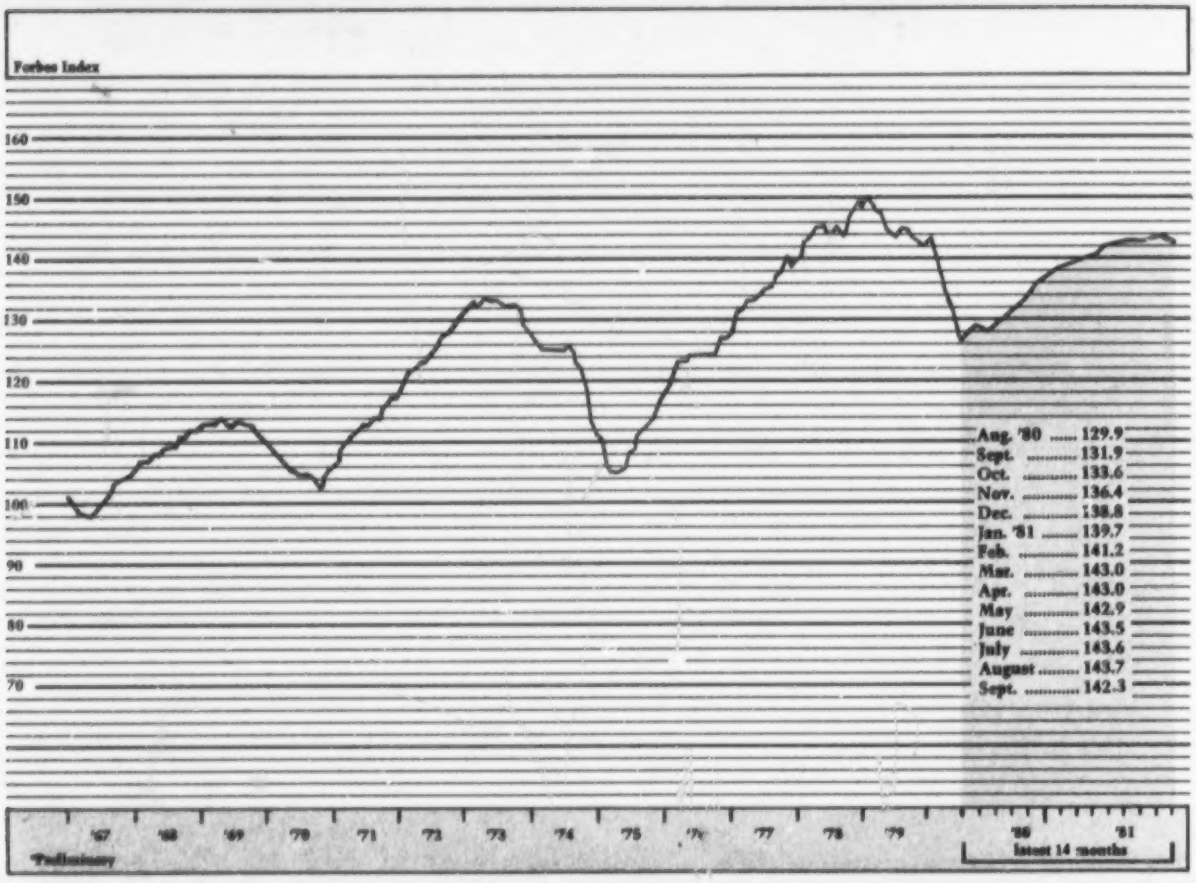
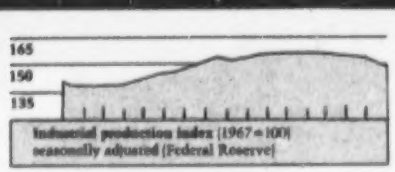
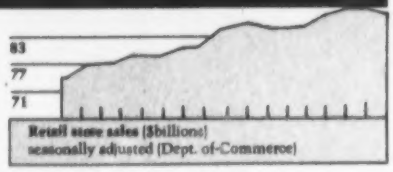
The Forbes Index

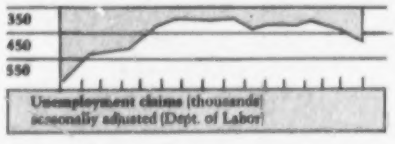


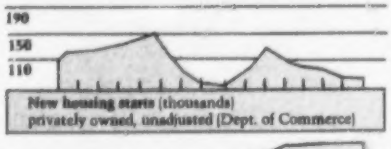
The Forbes Index Components

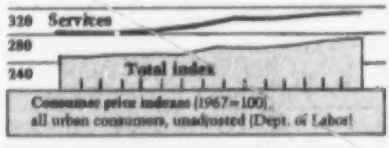
It's downhill from here. Initial indications are that the next figure for the Forbes Index is going to be even lower. Two key economic indicators—industrial production and retail sales—were each down 1.5% from the previous month. The fact that the economy is in a recession is no longer in dispute. Now it's a matter of how bad the slump will be.

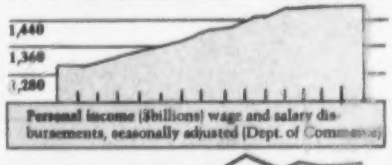


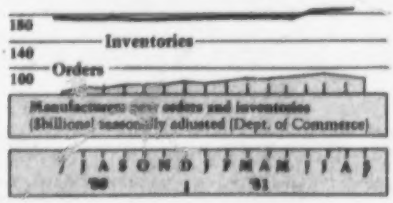


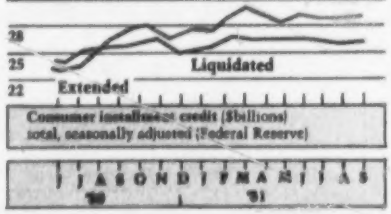












The Forbes Index is a measure of U.S. economic activity composed of eight equally weighted elements:

Total industrial production

New claims for unemployment compensation

The cost of services relative to all consumer prices

The level of new orders for durable goods compared with manufacturers' inventories

Total retail sales

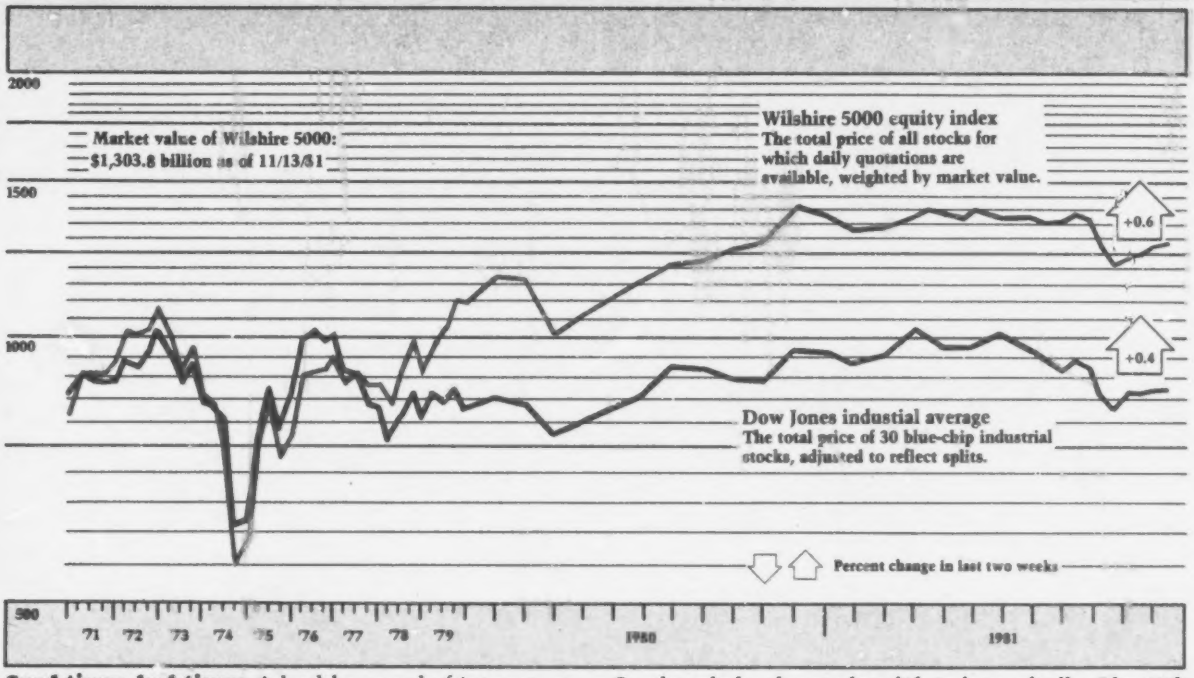
New housing starts

Personal income

The change in the amount of consumer installment debt outstanding

To measure these eight elements, Forbes monitors 11 series of U.S. government data. The last 14 months' data for each series is presented at right.

The Forbes/Wilshire 5000 Review



Good times, bad times. A healthy round of interest rate cuts helped Wall Street eke out some gains over the past two weeks. But investor enthusiasm was restrained by indications of continuing economic deterioration and the developing donnybrook in Washington. The little guys made the most out of this sweet and sour situation: NASDAQ stocks jumpd 2.5% and the ASE Market Value Index, 1.8% over the past two weeks.

Bigger-capitalization stocks, meanwhile, moved ahead only slightly—and selectively. The Dow Jones industrial average and the NYSE composite index were in the black, while the S&P's 500—a cross-sectional measure of America's industrial and financial heartland—retreated 0.2%. On the whole, the market didn't do too badly. The Wilshire, the most comprehensive measure, gained 0.6%, or more than $49 billion in market value.

Now, the optimists expect declining interest rates to drive capital out of money market funds and back into common stocks. Don't be too sure: Investors will have to feel more confident about the economy's overall strength before they are willing to go full throttle into the equity markets. In the meantime, money managers are doing a great deal of picking and choosing. The biggest emphasis was on stability, not speculation. Over the past four weeks, investors loaded up on low volatility, low-P/E, high-yield and higher priced securities.

Close-up On The Equity Markets

Performance of five leading indexes

Percent change	Wilshire 5000	Dow Jones industrials	NYSE Composite	ASE Market Value Index	NASDAQ Composite
in last 4 weeks	2.6	0.5	2.5	3.4	5.2
in last 52 weeks	–9.9	–13.2	–10.3	–9.8	–0.8

Stock performance based on five key investor yardsticks

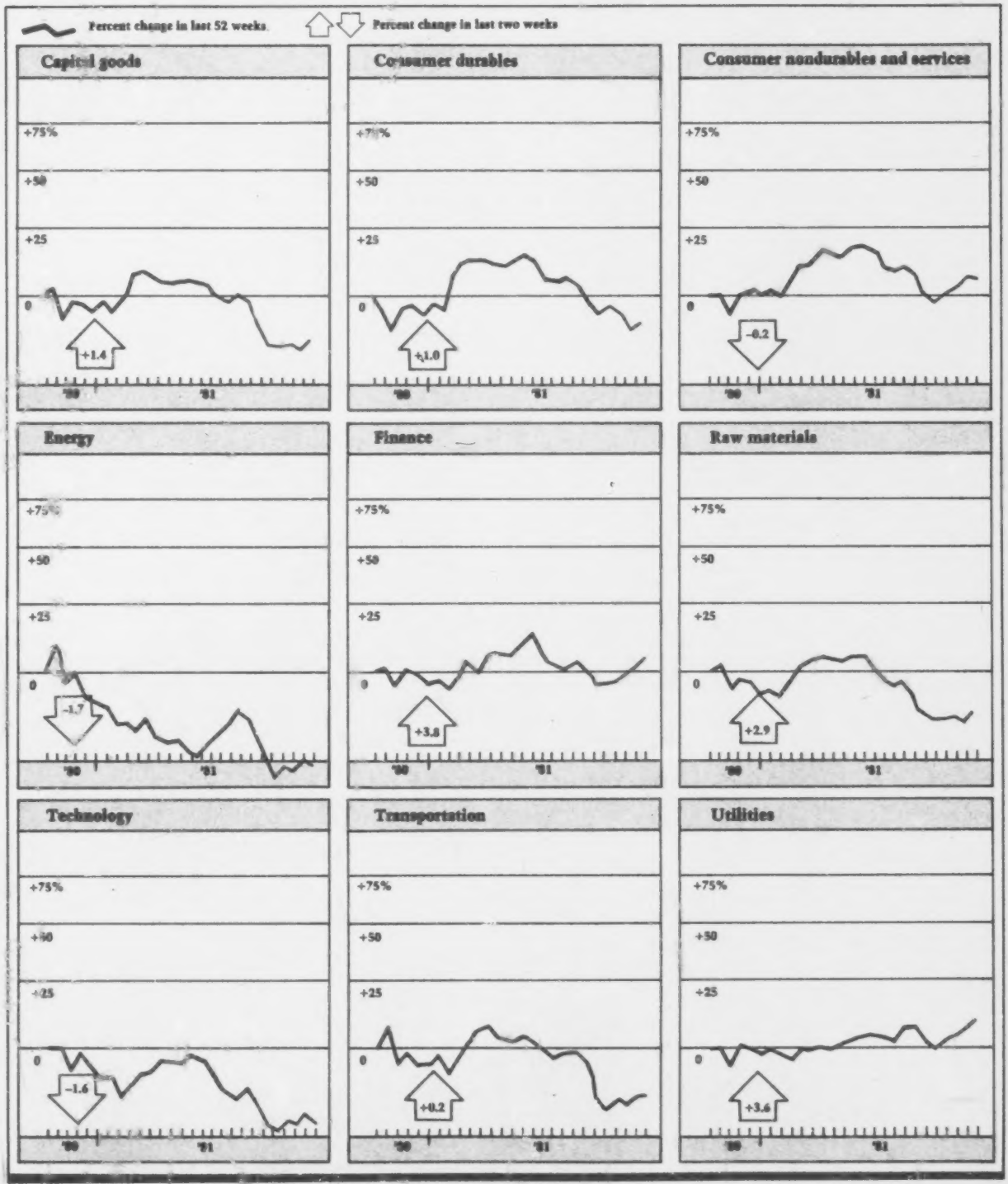
Percent change	Volatility *		P/E multiple		Dividend yield		Growth profile†		Share price	
	high	low	over 25	under 5	over 7.5%	none	high	low	over $40	under $4
in last 4 weeks	3.6	4.7	2.3	3.8	5.3	1.9	3.7	3.9	3.2	2.9
in last 52 weeks	–2.5	12.7	–11.1	4.5	9.1	2.0	–1.0	7.4	–5.0	8.6

* A stock's sensitivity to overall market movement. High-volatility issues have wide price fluctuations; low-volatility issues are more stable.
† A quantitative evaluation of a stock's growth image, determined by Wilshire Associates.

Note: All data for periods ending 11/13/81. Prepared by Wilshire Associates, Santa Monica, Calif.

Banking on cheaper money. A falling prime rate helped boost a large number of major banks to 52-week stock market highs. This pushed the finance sector to the head of the pack over the past two weeks with a 3.8% gain. Utilities also stand to benefit from lower interest rates, and they shared a similar-size gain. Other strong sectors were raw materials and capital goods.

Mobil's bid for Marathon skidded on several legal oil slicks, and this helped burn off some investor enthusiasm for energy stocks. The sector slid back 1.7%. In fact, all the recent episodes of merger fever have not been enough to counteract the effects of the oil glut. Over the past 52 weeks the energy group—the poorest performing of all nine traded here—fell over 27%. The second poorest performing sector has been the technology group. It lost an additional 1.6% in the most recent two weeks.



Note: All data for periods ending 11/13/81. Prepared by Wilshire Associates, Santa Monica, Calif.

If the cost of money keeps falling, some sharp earnings increases will come at those firms where creditors have been knocking loudly at the door.

The bright side of short-term debt

By Steve Kichen and Paul Bornstein

WHEN INTEREST RATES are climbing, short-term debt means big trouble. By definition short-term debt includes all obligations due in 12 months or less, and financing costs can move up just as fast as a soaring prime. The damage to earnings can be deadly.

There's a flip-side to this relationship. When rates are falling, companies with a hefty load of short-term debt will experience the joys of cheaper money almost immediately. That affects the income statement too, but in a positive way. Interest expenses are deducted before taxes. So for every dollar of short-term interest a company avoids, another 50 cents flows to the bottom line, assuming a 50% overall corporate tax rate.

Big corporations typically meet their short-term credit needs through the commercial paper markets, where they can get money for 30 or 60 days at as much as 400 basis points below prime. Many smaller companies, on the other hand, resort to straightforward bank credit. Sometimes this is priced well above the prime. The important thing to remember, however, is that both types of carrying costs will decline if interest rates continue to drop. This Statistical Spotlight attempts to measure that change in terms of per-share earnings.

The accompanying table ranks companies with high levels of short-term debt relative to net income. The third column—EPS gain with 1% interest rate drop—is the most interesting: It indicates how many cents per share a company's earnings are likely to rise with every 1% decline in interest costs. To make the table a company also had to show a profit over the latest 12 months and to have revenues of $82 million or greater. Since they are normally considered interest-

Statistical Spotlight

Measuring the gains from falling interest rates

If interest rates fall, so do carrying costs of short-term debt. These 25 companies, ranked by the ratio of debt to net income, should benefit immediately. The third column estimates per-share gains for every 1% drop in rates.

Company/principal business	Short-term debt/net income	Short-term debt (million)	EPS gain with 1% interest rate drop	Latest 12 months EPS	Latest 12 months P/E ratio	Latest 12 months revenues (million)	52-week price range	Recent price
Empire of Carolina/toys	109.7	$ 21.8	$0.10	$0.22	19.9	$ 82.8	9¼ – 3⅞	4⅜
Imperial Industries/building materials	47.1	6.3	0.01	0.06	31.3	102.8	3½ – 1¼	1⅞
TFI Cos/bldg materials, food	38.6	12.2	0.02	0.16	11.7	195.1	3⅛ – 1⅝	1⅞
Burroughs/computer equipment	35.6	613.5	0.08	0.41	NM	3,142.4	55¾–27⅛	31¼
Norlin/multicompany	34.3	12.0	0.03	0.19	NM	293.0	16⅞–12¼	15¼
Coastal Corp/refining, marketing oil	31.4	206.8	0.05	0.98	37.5	5,979.2	59½–25¼	36¾
Kellwood/apparel	30.6	111.8	0.16	1.04	9.7	616.7	13½ – 8⅝	10⅛
Elcor/engineering services	28.6	12.3	0.02	0.12	NM	274.0	19⅜ – 9½	11
Allied Products/metal fabricating	26.7	4.8	0.01	0.05	NM	270.3	11 – 7	8⅜
KDT Industries/retail	25.7	37.7	0.03	0.20	22.5	867.9	9¾ – 4½	4½
Jewelcor/retail jewelry	23.3	25.2	0.04	0.78	6.1	175.1	7⅝ – 3⅜	4¾
Struthers Wells/industrial equipment	21.3	13.6	0.02	0.24	40.6	82.5	26 – 9	9¾
Jim Walter/building materials	20.5	390.2	0.12	1.09	15.5	2,020.4	32 –16⅝	16⅞
Warner-Lambert/proprietary drugs	20.2	194.1	0.01	0.12	NM	3,442.0	25 –17	19¾
Newberry Energy/electrical construct	18.6	10.3	0.04	0.85	8.5	140.5	10¾ – 7	7¼
LSB Industries/industrial equipment	17.7	32.8	0.05	0.61	7.4	82.6	7 – 4	4½
Fairfield Communities/building	16.8	60.1	0.20	2.43	6.2	82.0	20⅝–11⅜	15
Saxon Inds/paper products, copiers	16.3	63.4	0.05	0.56	8.9	738.5	8⅞ – 4	5
CHB Foods/food processing	15.7	56.7	0.09	1.16	5.0	289.8	8½ – 5⅛	5¾
Resorts International A/hotels, casinos	15.1	22.4	0.01	0.14	NM	336.5	31⅝–12½	18⅝
Standard-Pacific/building	14.4	78.2	0.10	1.36	6.4	96.6	18⅛ – 8⅝	8¾
Faberge/cosmetics	13.5	26.1	0.02	0.34	51.5	260.5	28½–12	17½
Grolier/publishing	13.4	28.9	0.01	0.17	13.2	336.6	3⅛ – 1¼*	2¼
RCA/multicompany	12.4	868.2	0.06	0.02	NM	7,985.5	33 –16¾	17⅜
Gaylords National/retail	11.3	8.0	0.03	0.58	3.4	121.8	3½ – 1⅝	2

*Price range for 1981. NM: not meaningful.

Source: Standard & Poor's Compustat

sensitive stocks, banks, insurance and other financial institutions have been excluded.

As a look at the table indicates, some firms' lower interest rates will provide a handsome bonus. Fairfield Communities, for example, a real estate developer and builder with $60 million in short-term debt, might add another 20 cents per share to the bottom line for each 1% drop in interest rates. Another builder, Standard-Pacific, could add 10 cents with each 1% rate decline.

Although firms such as Imperial Industries and TFI Cos. do not show as much potential for absolute earnings change as Fairfield or Standard-Pacific, building companies in particular offer a double-barreled advantage. A drop in interest expense adds a few cents immediately to earnings, a much stronger kicker is likely to come from an industry turnaround sparked by lower mortgage rates.

Seasonal borrowing to finance inventories also puts a heavy short-term debt burden on many companies—and a drop in these costs would be especially good news for several firms. Empire of Carolina, a toy manufacturer, is a good example. Our estimates show that for every 1% drop in interest rates Empire could add another 10 cents in earnings. Empire earned just 22 cents during the latest 12 months, so a 2% drop in rates may mean earnings will double. Similar though less dramatic changes in earnings could come at Allied Products, Elcor and Imperial Industries.

Be aware, however, that there is considerable variation in the cash positions of some of the firms in our table. Burroughs, for instance, has over $600 million in short-term debt, which it is using to support finished inventories. It may need to borrow more to help finance the Memorex merger. With only $49 million in cash and cash equivalents, the big computer maker is hardly flush with funds. Norlin, on the other hand, also has relatively high amounts of short-term debt, but it is in the process of selling its technology group for approximately $56 million and is holding $12.3 million in cash and equivalents.

No matter how dramatic the projected benefits of lower interest rates look for some of these corporations, there is a dark cloud behind this silver lining of cheaper money. Rates are falling, in part, because the economy is headed into a recession—something that may well offset the gains of reduced borrowing costs. Still, good news is where you find it, and these estimated earnings improvements are easy to quantify, company by company. The potential damage of an overall economic slump isn't.

Something else could go wrong, too. Suppose that interest rates don't continue their decline. Some smart economists—Salomon Brothers' Henry Kaufman for one—think that rates will bottom out soon and then soar to even greater heights than those they hit earlier this year. If that happens, ignore this table. Or better yet, put a mental minus sign in front of those earnings gain estimates in the third column. Then it makes a great sell list. ■

The Money Men

Reagan's economic program sets the stage for a major bull market, says Ken Smilen, who warns investors not to get impatient if the curtain doesn't go up right away.

One vote for "rational man"

By Richard Phalon

IS THERE HOPE after David Stockman? Kenneth B. Smilen, chairman of Smilen & Safian, Inc., a small New York-based research firm with a solid institutional following, is one of the few Wall Streeters willing to say "yes," and say it out loud these days. Looking beyond the headlines screaming of inflation, deep deficits and doom, he sees a major bull market ahead in both stocks and bonds. In the great brouhaha over supply-side economics, says Smilen, almost everyone has lost sight of truly epochal changes in the Economic Recovery Tax Act of 1981— changes that in terms of sheer potential he ranks with nothing less than the Homestead Act, the use of federal funds for a transcontinental railroad, the creation of the Federal Reserve System and the Employment Act of 1946.

Smilen, 48, a soft-spoken, scholarly Brooklyn College graduate who has called a number of major market turns over the years, is no acolyte of Reaganomics. A lifelong Democrat, and a former self-styled liberal Democrat at that, he argues that the incentives unleashed by the 1981 tax act will force a major change in the way Americans save and invest.

The "extreme generosity" of the law, he argues, is something of a historical necessity—a signal from Congress to capitalism, with the full approval of the electorate, that the nation is no longer prepared to live with runaway inflation.

"It's a revolution," says Smilen. "There are real incentives to save rather than spend and for the first time in years, businessmen will be able to invest with a clear idea of the political climate."

Among the incentives, Smilen ticks off such major boons as much more liberal depreciation allowances, reductions on the capital gains tax and the "max tax" on unearned income, and the extension of individual retirement accounts to all wage earners. He sees the impact of the IRAs on saving and spending as particularly meaningful."Instead of making a $200-a-month payment to a credit card," says Smilen, "people will be putting that money to work in the markets."

Smilen is a child of the light. He sees rational man at work, responding to stimuli that have always worked in the past. Thus, he argues, a higher rate of tax-sheltered savings will cut into inflation by reducing consumption. The return of incentive stock options will make managements focus on long-term planning rather than on short-term opportunistic views. Says Smilen: "We have to break the inertia from such obvious business contrac-